Clark County, Washington

Investment Management Review
Fourth Quarter 2001

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After months of economic data suggesting that it was only a matter of time until the economy entered a recession, the National Bureau of Economic Research (NBER) announced in December that the United States' longest period of economic expansion ended months earlier in March 2001 when the U.S. economy officially entered into a recession. Recent economic indicators suggest some stabilization in consumer confidence, manufacturing activity, and employment; which has helped poise the economy for a recovery in 2002. Market observers have mixed views on the strength and timing of an economic recovery, which has led to wide swings in interest rates as the markets digest new information.

The County pool portfolio had a par value of $504 million as of December 31, 2001, a modest increase from the previous quarter's $450 million. This increase was due to the Vancouver School District depositing $57.7 million into the Pool at the end of the fourth quarter. The portfolio was slightly restructured shifting away from Certificate of Deposits into the Washington State Local Government Investment Pool. The Pool portfolio remained well diversified by sector and maintained a high overall credit quality, liquidity, and exposure to call/reinvestment risk. A summary of fourth quarter highlights and PFM's recommendations follow.

Sector Composition Comparison

	12/31/2000	9/30/2001	12/31/2001	Quarter Change
Certificates of Deposit	1.3%	4.4%	0.0%	(4.4%)
Commercial Paper	16.9%	2.2%	2.0%	(0.2%)
Federal Agency Discount Notes	3.9%	8.9%	7.9%	(0.9%)
Federal Agency Notes	58.7%	54.4%	52.6%	(1.8%)
Treasury Securities	7.8%	4.4%	6.9%	2.5%
Municipal Obligations	1.3%	1.1%	1.0%	(0.1%)
Passbook/Money Market Accts	10.0%	24.5%	29.5%	5.0%
Totals	**100%**	**100%**	**100%**	

*Based on par values of securities in pool portfolio.

- ***Asset Diversification* –** The asset allocation of the portfolio changed only slightly quarter-over-quarter. The allocation to Money Market Accounts increased modestly by 5.0 percentage points. This shift in emphasis came as a result of less exposure to Certificate of Deposits and Federal Agency securities.

- ***Maturity Distribution* –** The County's pool portfolio maintained an average maturity of 9.0 months during the quarter. PFM's suggested maturity target has been slightly lowered to 8-9 months in light of the current level of interest rates. Therefore, our recommendations in this report include suggestions to maintain the duration within this recommended target band.

- ***Credit Quality*** – The County maintained the portfolio's low exposure to credit risk. As of the end of the quarter, 70% of the portfolio was invested in securities rated "AAA" (highest long-term rating) or "A-1 / P-1" (highest short-term rating). 29% of the portfolio was invested in the un-rated State LGIP.

- ***Liquidity* –** As of December 31, 97% of portfolio assets were categorized in one of PFM's top three liquidity rating categories (1, 2, and 3). The overall weighted liquidity factor was 2.54, well within PFM's recommended range of 2 to 4.

- ***Market Risk*** –The Pool remains principally invested in securities maturing under 2-years as of December 31, classifying 87.1% of the portfolio in the low to low/average categories of market risk.

- ***Callable Exposure*** – The total portfolio's exposure to call risk inched lower to 12% due to the increase in portfolio size. This allocation is in line with PFM's maximum recommended limit of 20% to 25%.

- ***Performance*** – Over the past twelve months, the total return of the County pool portfolio was in-line with the Merrill Lynch custom Treasury benchmark having an average maturity of nine months.[1] Since January 1999, the pool portfolio produced an annualized total market value return of 5.85%.[2] During this time period, the Merrill Lynch custom benchmark produced an annualized return of 5.61%. The performance of the County pool exceeded the Merrill Lynch custom benchmark by 24 basis points (0.24%) on an annualized basis.

As described in more detail in the accompanying report, the investment strategy employed by the County Pool appears to be prudent and appropriate given the County's historic cash flow patterns and current market conditions.

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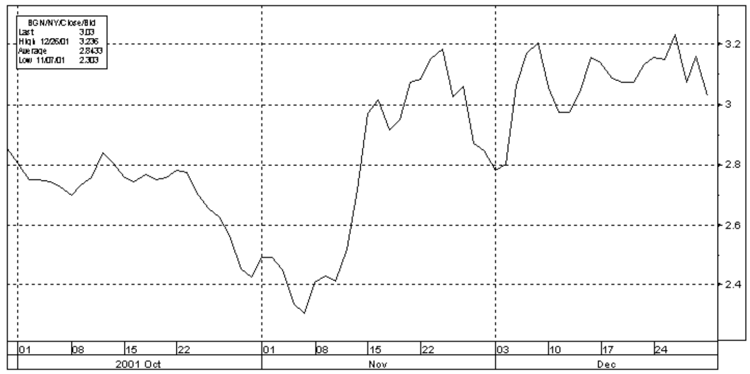
[1] The Merrill Lynch custom Treasury benchmark is currently comprised of two Merrill Lynch Treasury Indices. The custom benchmark consisted of 50% of the Merrill Lynch 6-Month Treasury Bill Index and 50% of the Merrill Lynch 1-Year Treasury Bill Index through August 2001. Upon the discontinuance of 1-year Treasury Bills by the U.S. Treasury Department, the Merrill Lynch 1-Year Treasury Note Index has been substituted.

[2] Clark County pool portfolio returns were calculated and provided by the County's Treasury Office.

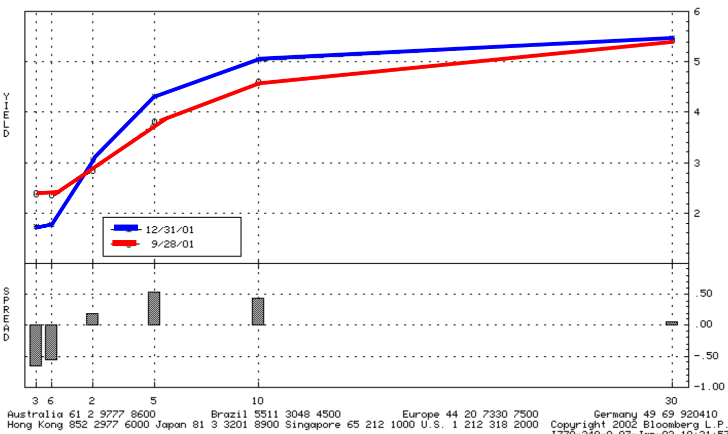
Fourth Quarter 2001 Economic Summary

2 Year U.S. Treasury Yield History
September 28, 2001 – December 31, 2001



The fourth quarter may have marked a major turning point in interest rates. For the first part of the quarter, trends that were in place for much of 2001 continued to push rates to historic lows. The Federal Reserve cut its Target Federal Funds rate an additional 125 basis points (1.25%) during the quarter, lowering the rate to 1.75%, in its continued efforts to stimulate growth in the economy. The yield on the 2-year Treasury Note, which had declined since the middle of 2000, continued to drift lower during October and reached a 40-year low of 2.30% on November 7th. This pattern changed dramatically in the last seven weeks of the quarter as investors became less bearish on the economy and pushed intermediate and long-term rates higher before the year ended. The result was that for the entire quarter, the yield on the 2-year U.S. Treasury Note actually *rose* by 20 basis points (0.20%) from 2.85% to 3.05%. The 5-year Treasury Note yield increased by more than 50 basis points (0.50%) to 4.33%, and the 10-year Treasury Note increased from 4.59% to 5.03%. Despite an announcement by the Treasury Department that it would discontinue the issuance of the 30-year Treasury Bond, the long bond remained relatively unchanged with a yield of 5.48% at the end of the quarter. Short-term rates followed the Federal Reserve's lead, with the yield on the 3-month Treasury Bill falling 66 basis points (0.66%) to 1.71%. The 6-month Treasury Bill dropped 55 basis points (0.55%) resulting in a yield of 1.79%. The result was a significant steepening of the yield curve, which is often a precursor to higher rates ahead.

U.S. Treasury Yield Curve
September 28, 2001 – December 31, 2001



The equity markets recovered much lost ground in the quarter, providing another sign that investor sentiment on the economy was improving. The Dow Jones Industrial Average rose 13%, while the Standard & Poor's 500 Index moved higher by 10%. The tech-heavy NASDAQ Composite also bounced back, regaining the 30% it had lost in the third quarter.

As in the third quarter, performance between Federal Agencies and U.S. Treasuries somewhat favored Agencies. During the first three quarters of 2001, portfolios benefited from an over-weighting in Federal Agencies as yield spreads narrowed from historic wide levels versus comparable Treasuries. This trend generally continued in the fourth quarter with returns on Federal Agency securities outpacing those of U.S. Treasuries. Returns of high-quality corporates exceeded somewhat those of Treasuries and Agencies, but returns of A-rated corporates lagged. This reflected investor concerns about corporate credit in the face of the current economic downturn. As the slope of the yield curve became steeper during the fourth quarter, returns of longer portfolios suffered, in a reversal of their stunning performance in the prior quarter. For example the Merrill Lynch 1-3 year U.S. Treasury Index had an annualized return of 3.06% for the fourth quarter compared with a -1.88% annualized loss for the longer-term

Merrill Lynch 3-5 year Treasury Index and an annualized return of –8.7% for the 10 Year Treasury Index.

The fourth quarter came at the end of a year that marked one of the sharpest bond market rallies in history. As the economy weakened throughout 2001 and the stock market faltered, investors bid up the prices on fixed-income instruments, the Federal Reserve aggressively eased short-term rates, and fixed income investments performed exceptionally well for the year. For example, the Merrill Lynch 1-3 year U.S. Treasury Index had an annualized return in excess of 8%.

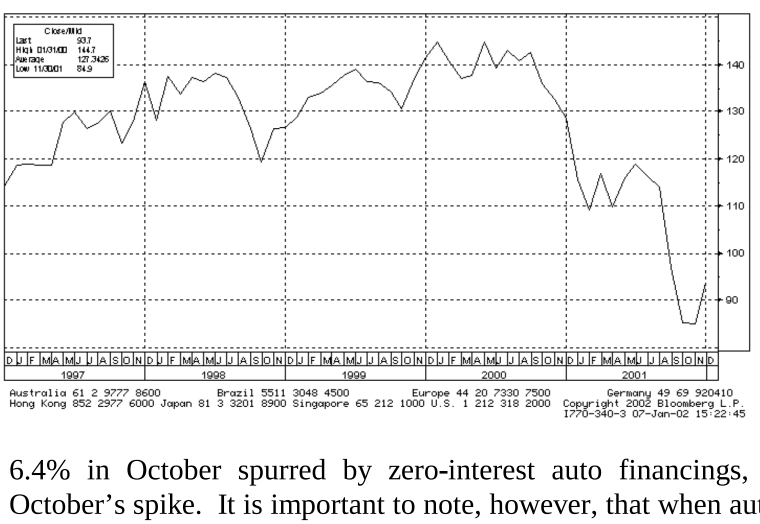
THE ECONOMY In mid-December, the National Bureau of Economic Research (NBER) announced that the United States' longest period of economic expansion ended in March 2001 and that the U.S. economy was officially in recession. Economic data released during the quarter continued to show economic weakness along with some potential signs of stabilization in the economy.

EMPLOYMENT U.S. companies continued to downsize throughout the quarter. The unemployment rate rose to 5.8% in December, up nearly 1% over the last three months. This is the highest level of unemployment the country has seen since April 1995. While companies like Ford continue to announce cuts to its workforce, initial jobless claims remain high but appear to have leveled off in December.

MANUFACTURING ACTIVITY The index survey by the Institute for Supply Management (ISM), formerly the National Association of Purchasing Management in October measured its weakest reading of manufacturing activity since the recession in 1991. However, higher than expected numbers were posted in November and December, pushing the index to 48.2%, its highest reading in a year. A reading below 50 still indicates contraction in the manufacturing sector, but December's numbers have been viewed positively with growth in the new orders and production components of the index. This suggests the manufacturing sector may grow early in 2002. ISM's survey of non-manufacturing businesses was also strong during the quarter with November and December showing growth.

CONSUMER CONFIDENCE The survey of consumers taken by the Conference Board remains down from its highs of the last four years but above the low levels seen after the events of September 11th. The Consumer Confidence index moved sharply higher in December to a level of 93.7 from 84.9 the month prior. This strong increase was due to more positive consumer expectations on the state of the economy. Consumers gave their present situation slightly higher marks, but it was their belief that the worst might be behind them that brought the survey to a 3-month high.

U.S. Consumer Confidence
December 31, 1996 – December 31, 2001



RETAIL SALES Month-to-month retail sales have been understandably volatile. Sales fell 2.2% during the consumer-spending pullback in September. Retail sales then surged 6.4% in October spurred by zero-interest auto financings, then dropped 3.7% in November after October's spike. It is important to note, however, that when auto sales are excluded, the sales' results for the quarter look much less volatile and show relatively modest growth. Year-over-year retail sales (including autos) have grown 4.1%.

GROSS DOMESTIC PRODUCT (GDP) GDP for the third quarter was revised downward to minus 1.3% from a preliminary minus 1.1%. This was attributed to a revision in government spending, consumer expenditures, and higher than initially reported inventory liquidations. Despite the fact that the economy stumbled along with 0.3% growth in the second quarter, this quarter's indication of contraction was one of the first tangible signs that the economy was in recession.

CONSUMER AND PRODUCER PRICES Consumer prices remained relatively flat throughout the quarter. This was primarily a result of reduced energy prices including a 10% decline in gasoline costs. Hotel prices rose during the quarter, which was seen as a rebound from the October declines. Year-over-year inflation as measured by CPI has remained near 2%. Producer prices were also affected by the decline in energy prices. Overall producer prices fell by over 2% in the quarter, with an October decline being the highest one-month drop in the measurement's history.

Sector Distribution

The table below compares the portfolio composition of the County pool for the past two quarters and one year ago. In a declining rate environment, money market accounts, such as the Washington State Local Government Investment Pool, typically offer a higher yield than other short-term money market instruments. The County took advantage of this opportunity by increasing the allocation to money market funds from 24.5% to 29.5%. As of December 31, 2001, the County pool maintained a balance of approximately $149 million in passbook/money market funds. This was an increase of about $39 million since September 30, 2001. The allocation to U.S. Treasuries increased with the purchase of $20 million in 2-year Treasury Notes in November. This increased the allocation to the Treasury sector from 4.4% to 6.9%.

As a result of these changes, the allocation to several other short-term money market sectors was reduced minimally. The most notable change was the allocation to Certificate of Deposits, which declined from 4.4% to 0.0% of the portfolio. This was due to the maturity of $20 million in Certificate of Deposits that were purchased in May. As of December 31, 2001, the portfolio remains well diversified.

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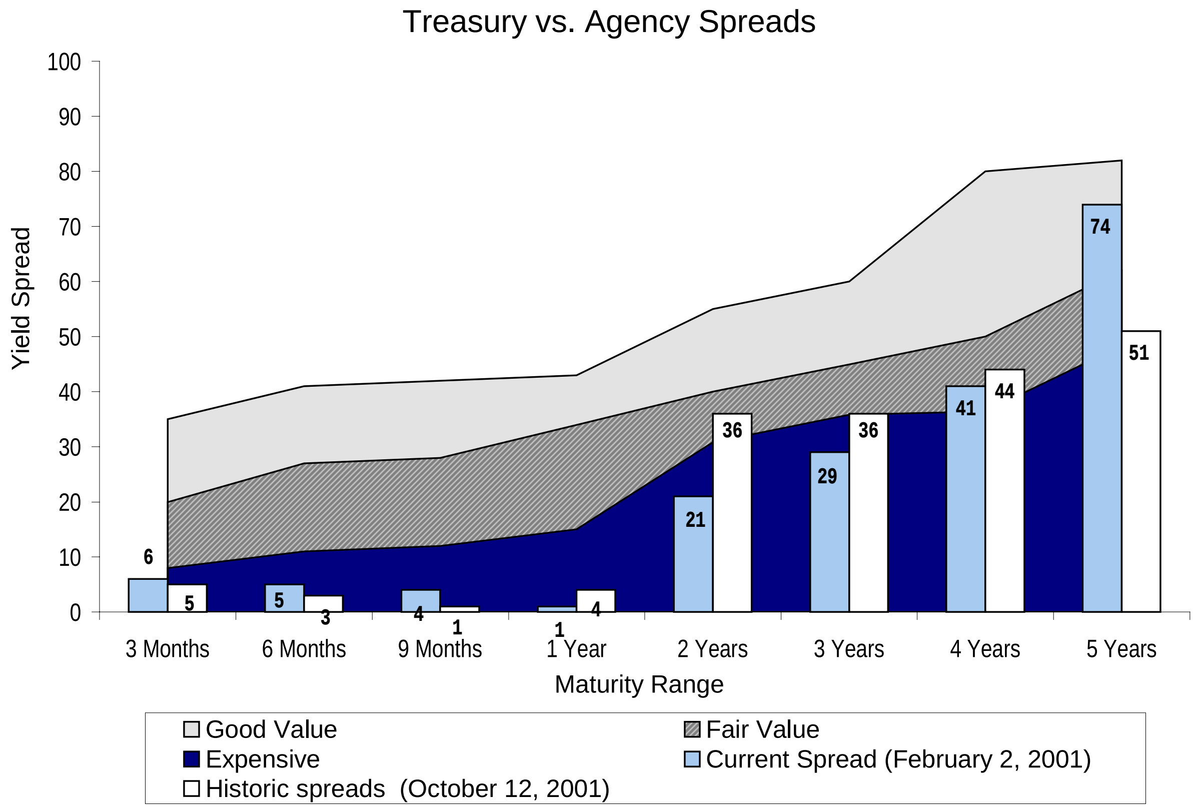
*Based on par values of securities in pool portfolio.

During the quarter, the Federal Reserve cut short-term rates by 125 basis points (1.25%) to help stabilize consumer confidence in wake of the continued economic fallout from the terrorist attacks on September 11th. In light of this declining rate environment, money market accounts continued to offer higher yields than alternative market sectors. At the end of December, the Washington State LGIP reported a distribution rate of 2.31% - well above the rate on short-term investment options. We recommend that the County continue to invest short-term funds in the State Pool as long as the Pool pays a rate above the prevailing market rate.

As depicted below spreads between U.S. Treasuries and Federal Agencies are quite narrow, especially on securities that mature within one year. We recommend that the County monitor the performance of U.S. Treasuries relative to Federal Agencies and increase the portfolio's allocation to the Treasury sector if Treasuries maintain this strong relative value.



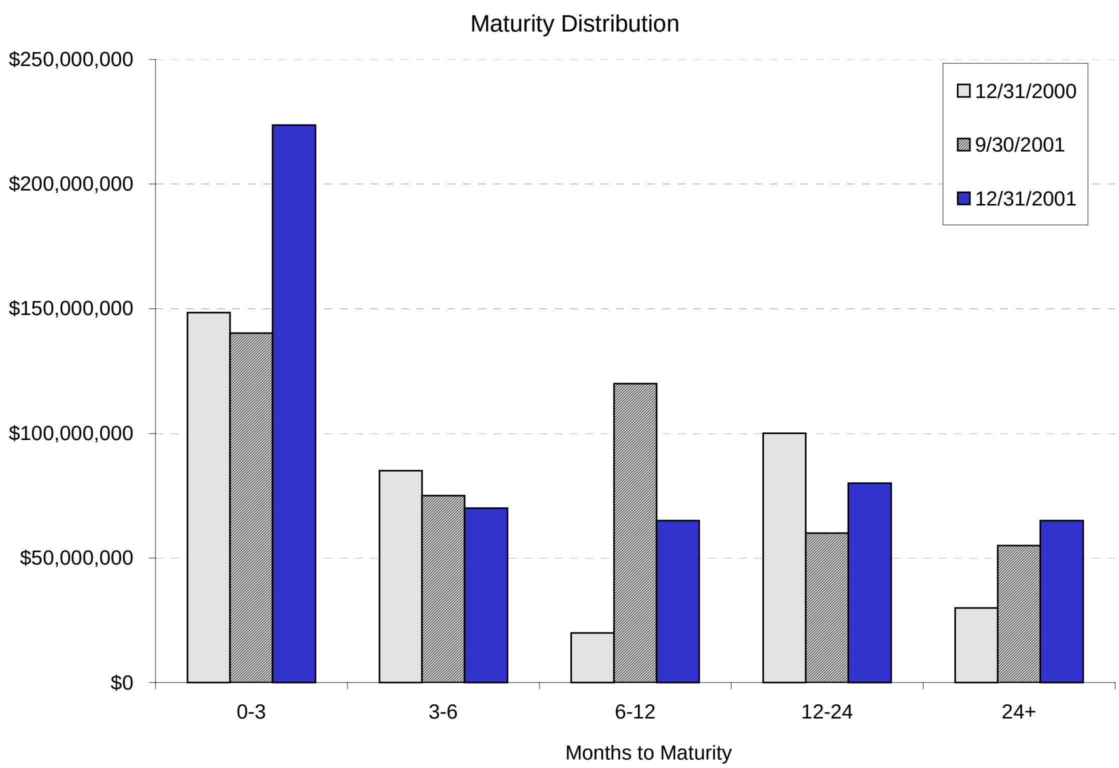
Maturity Distribution

As of December 31, 2001, the portfolio remained liquid with 44.4% of the Pool's holdings maturing within 3 months. This high "cash" allocation was the result of the deposit of a large bond issue into the Clark County Pool at the end of the year. During the fourth quarter, the average maturity decreased from 9.8 months (294 days) to 9.0 months (269 days). The County maintained the portfolio duration in this range by investing approximately $45 million in U.S. Treasuries and Federal Agency Notes maturing between October 2003 and May 2004.

The current average maturity of the Pool is within PFM's suggested average target maturity. As previously mentioned in PFM's Second Quarter Investment Management Review, portfolios that have a number of callable securities should be analyzed based upon average maturity and also by the concept of effective duration. Effective duration is a measure of the actual price sensitivity of the security given current market rates and recognizes the changing value of the imbedded call options. As of December 31, 2001, the effective duration of the County Pool was 0.48 years or 5.7 months. This compares with an effective duration of 0.72 years or 8.6 months as of September 30, 2001.

Looking forward, we recommend that the County maintain an average weighted maturity in the 8 to 9 month range and an effective duration of roughly 7 to 8 months. In order to maintain this target range while maximizing interest earnings, PFM would recommend a 'barbell' investment strategy. We would advise maintaining a significant portion of funds allocated to money market accounts, such as the State LGIP. To maintain this recommended average weighted maturity, the County may need to invest a portion of maturing funds in longer-term securities. We would suggest purchasing a combination of U.S. Treasuries and Federal Agencies with maturities between 2 and 3 years to maintain a diversified portfolio.

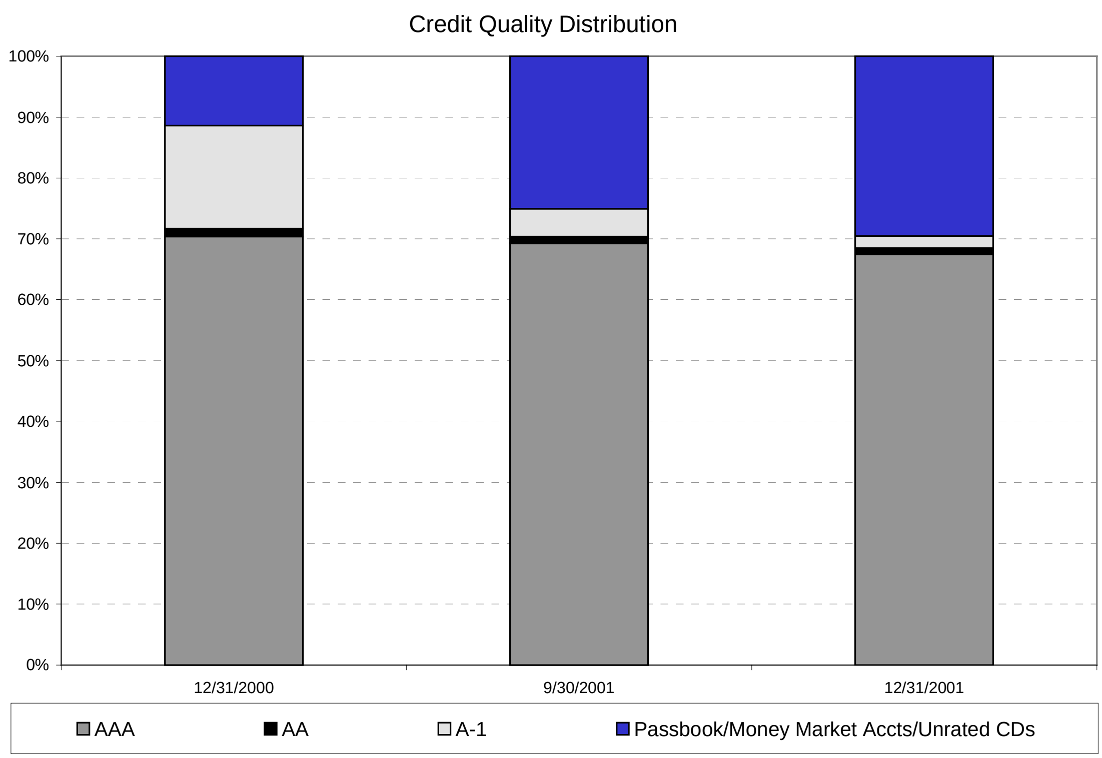
The chart below illustrates the maturity distribution of the County's portfolio as of December 31, 2001, the prior quarter end, and the distribution a full year ago.



Credit Quality

As of December 31, 2001, 69% of the portfolio was invested in obligations rated "AAA" or "A-1/P-1", compared to 72% invested in "AAA" and "A-1/P-1" as of September 30. Nearly 30% of the portfolio was invested in the State LGIP, which does not maintain a credit rating. The overall high credit quality of the portfolio continues to be maintained by the County's investment strategy.

The chart below shows the credit quality distribution of the portfolio as of December 31, 2001, compared to September 30, 2001, and December 31, 2000.

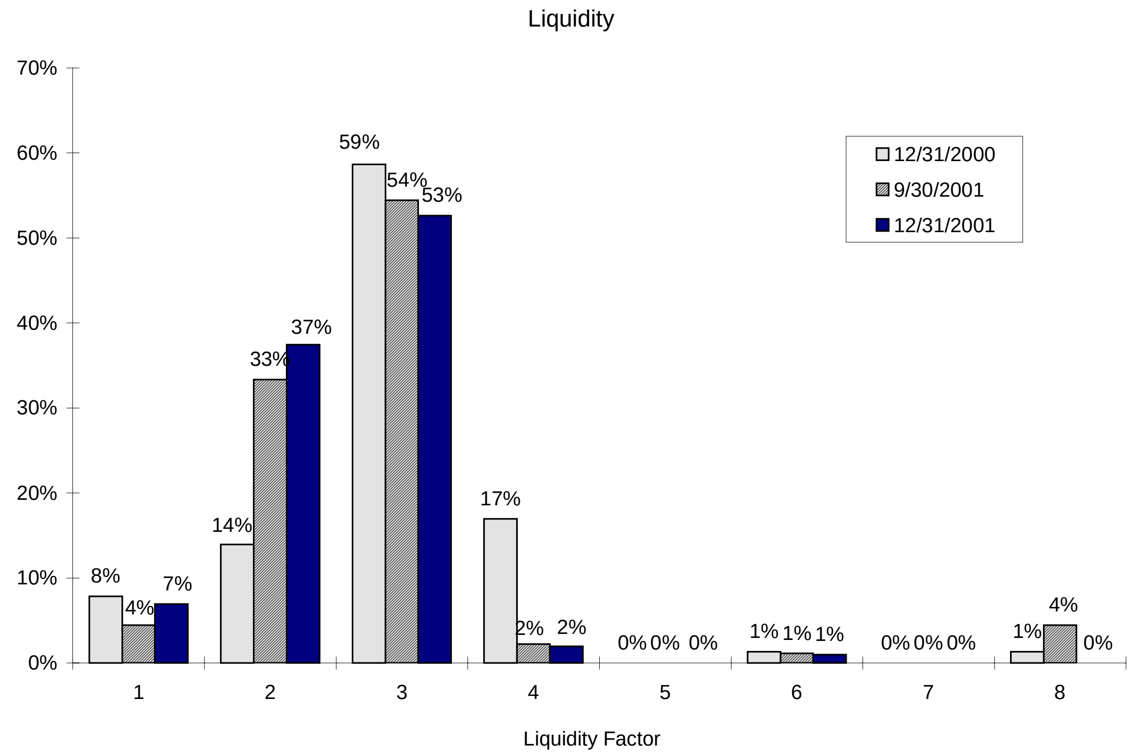


Liquidity

The County's portfolio remains highly liquid. As of December 31, 2001, 97% of the portfolio was invested in obligations rated among one of PFM's three highest liquidity-rating categories (1, 2, and 3), with the remaining 3% invested in high-quality commercial paper and municipal obligations.

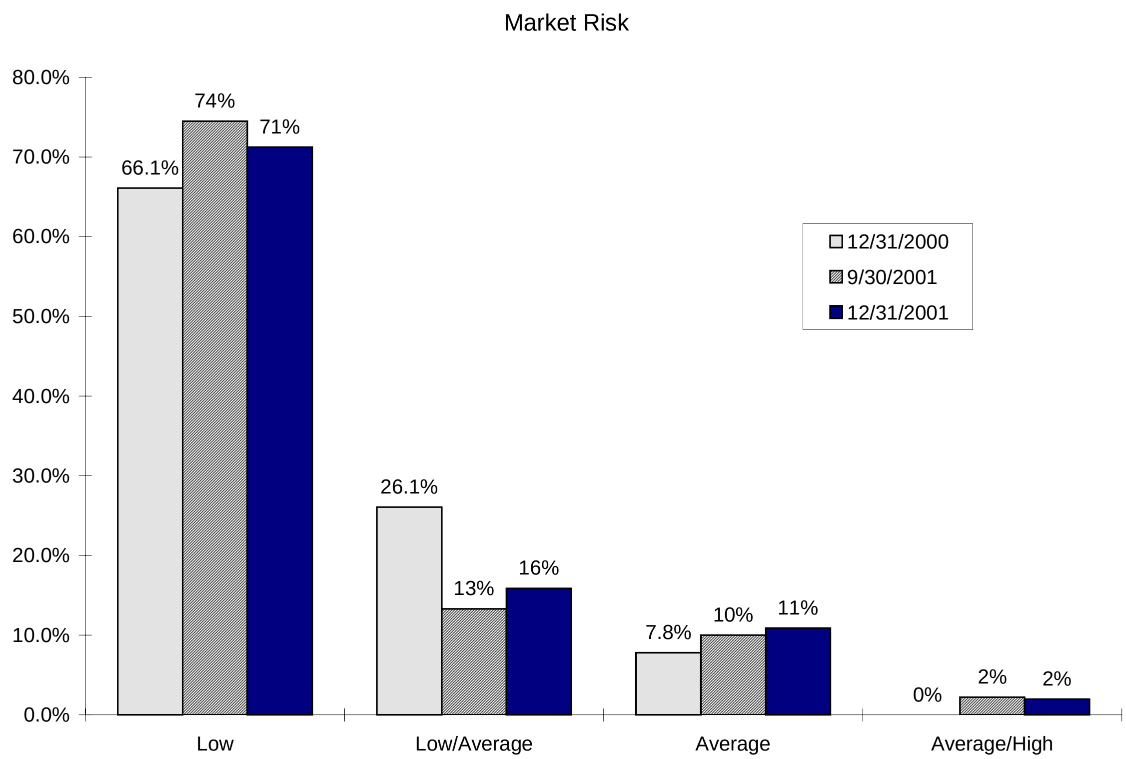
During the quarter, the liquidity risk of the portfolio decreased modestly from 2.86 as of September 30, 2001, to 2.54 as of December 31, 2001. The County increased its allocation to U.S. Treasuries, which raised the percentage allocated to Category 1 by 2.5% from 4.4% to 6.9%. The portfolio remains well within PFM's recommended liquidity range of 2 to 4.

The chart below shows the liquidity distribution of the portfolio as of December 31, 2001, compared to September 30, 2001, and December 31, 2000. Category 1 represents securities that can be easily sold with little difference between the bid and offer prices, such as U.S. Treasuries. Category 8 represents securities that are generally considered illiquid such as non-negotiable certificates of deposit.



Market Risk

Approximately 71% of the portfolio is invested in securities with maturity dates less than 365 days. These holdings are classified as having a low exposure to market risk. Nearly 87% of the portfolio was invested in securities with maturities under 2 years and can be categorized as maintaining a low or low/average exposure to market risk. $65 million par was invested in securities that matured beyond two years at the end of the quarter with $50 million of these securities being callable before May. The chart below shows the portfolio's exposure to market risk as of the current quarter end, 3 months ago, and one year ago.

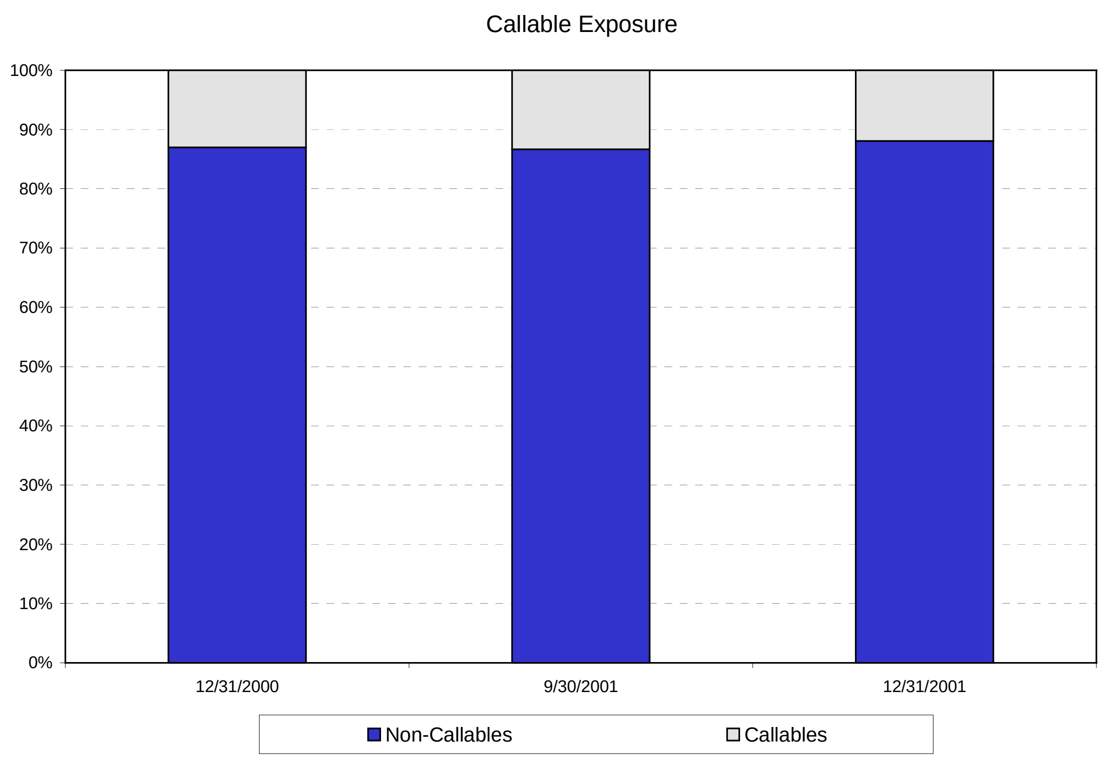


Securities in the portfolio are shown to their ultimate maturity date. Because a number of the longer-term holdings are callable, it is possible that they will be called prior to maturity. Therefore, this analysis may slightly overstate the market risk in the portfolio.

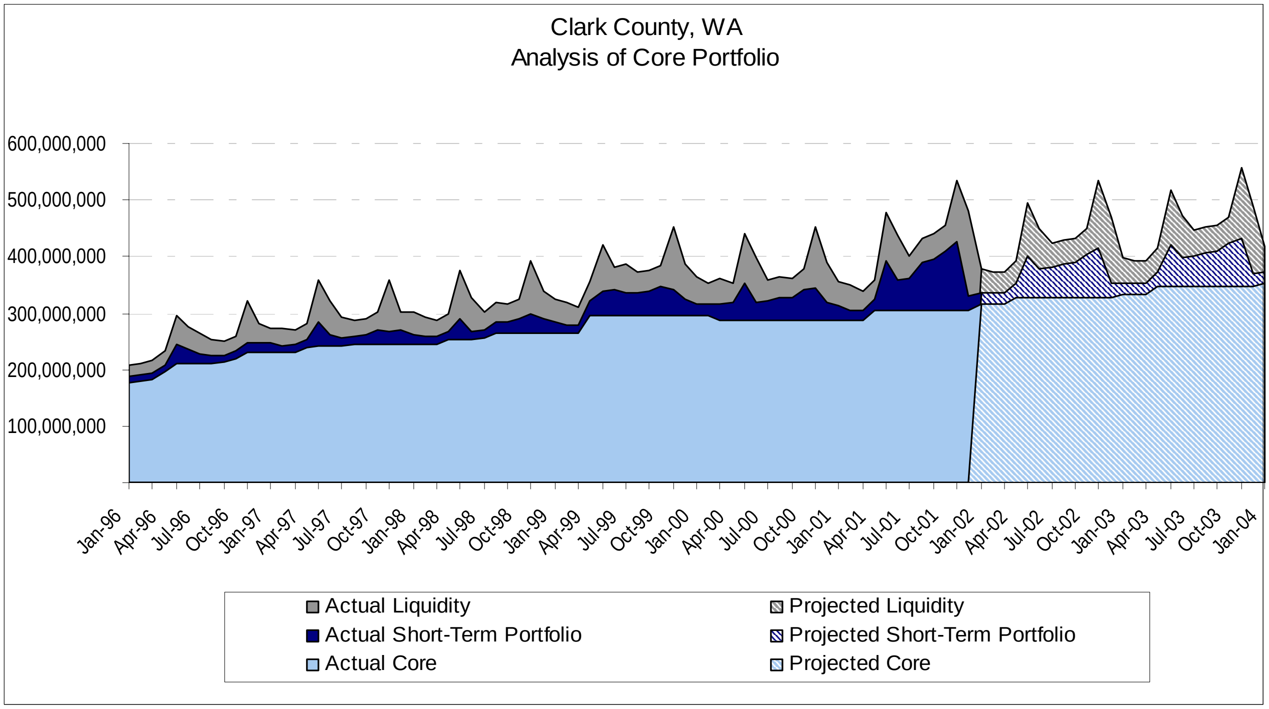
Call Exposure

The portfolio's allocation to callable obligations remained unchanged with $60 million in callable Federal Agencies held by the Pool as of December 31, 2001. This represented approximately 12% of the total funds invested by the Pool. This is well within PFM's recommended maximum of 20-25% allocation in callable securities.

These callable securities were all purchased in 2001 with nearly a year of call protection. The first call dates for all of these securities will occur between February and May 2002. With interest rates remaining at historic lows, these securities will likely be called.



The chart below represents cash flow projections for the County's portfolio. The model is based on changes in historic balances from January 1996 to December 2001. The data on the left side of the chart represents actual historical data. The data on the right side represents projected balances. Projections are based on historical seasonality[3] and a 5% annual growth rate.



The portfolio is allocated among the following three components: 1) Liquidity – representing funds needed to cover cash needs in the upcoming month. These funds are typically invested in very short-term money market instruments and the State LGIP. 2) Short-term portfolio – this includes funds set aside to provide liquidity for anticipated disbursements in two to six months and an added cushion should liquidity requirements suddenly increase. And 3) Core – this represents the portion of the portfolio that can be invested in longer-term obligations to achieve higher rates of return over the long run.

As reflected by the chart, the County's portfolio balance predictably reaches its peaks in May and November and its low points in March and September. The results of this analysis suggest that the portfolio will experience a sizeable net cash outflow beginning in January and lasting through March until receipts from property tax collections are received in April and May.

[3] A predictable change in the monthly balance from year-to-year due to the timing of cash inflows and outflows.

The following table focuses on the relative value of shorter-term investments between sectors. The table illustrates the current yield spreads and the 6-month average spreads of various securities as compared to U.S. Treasury Bills in the same maturity range. The table also provides an evaluation and current outlook of PFM portfolio managers on the short-term market. Since the County needs to maintain a relatively high degree of liquidity in its portfolio, this may serve as an additional reference for evaluating trade opportunities in the current market.

REVIEW OF INVESTMENT SECTORS

2/4/02	Sector Spreads to U.S. Treasuries								Current Evaluation	Recommendation & Outlook
	60-90 days		120-180 days		180-270 days		270-360 days			
Sector US Treasury Bills	1.66%	6 mo. Avg.	1.73%	6 mo. Avg.	1.82%	6 mo. Avg.	2.19%	6 mo. Avg.		
Agency Discount Notes	0.06%	0.08%	0.05%	0.06%	0.04%	0.05%	(0.01%)	0.03%	FAIR HOLD OR BUY	D/N are fair. Bills continue to be more attractive in comparison.
Non-callable	0.07%	0.10%	0.07%	0.10%	0.05%	0.08%	0.02%	0.06%	FAIR HOLD OR BUY	Federal Agency Notes are in-line with Agency D/Ns, not much pickup to U.S. Treasuries.
Callable (1yr/3month)							0.13%	0.17%	CHEAP HOLD or BUY	New issue callable securities have recently been issued.
Bankers Acceptances	0.10%	0.09%	0.04%	0.07%	0.02%	0.04%			FAIR HOLD OR BUY	BA's are fair, very limited supply.
Commercial paper	0.12%	0.12%	0.10%	0.11%	0.11%	0.09%			FAIR - CHEAP HOLD OR BUY	CP is trading close to CD's and BA's, has value in the short-end.
Repurchase Agreements (Term)	0.06%	0.08%	0.01%	0.04%					EXPENSIVE HOLD	REPO offers little to no value, 2 months and out.

The Federal Reserve left the Federal Funds Rate unchanged at its January 31st meeting. In its statement, the FOMC pointed out that "the outlook for economic recovery has become more promising." However, the FOMC guided investors that they will not be quick to raise rates in the near term with a cautious statement saying, "the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future."

At the present time, the State LGIP still offers good value along with excellent liquidity. (Typically when interest rates drop swiftly, as they did throughout last year, money markets accounts, such as the LGIP, "lag" the market by offering a higher yield than can be obtained on the open market.) We feel that the State LGIP will likely offer the best relative value for most of the first quarter. However, we still recommend that the County evaluate alternative investment sectors, such as high-quality (A-1) commercial paper and collateralized certificates of deposit, against the LGIP.

Provided below is a summary of PFM's recommendations.

- **Increase allocation to U.S. Treasury obligations.** Yields between Federal Agencies and U.S. Treasuries have narrowed considerably in the 6 – 18 month maturity range. With $10 million in Treasuries maturing at the end of January and February, we would recommend reinvesting these funds into U.S. Treasury obligations. In addition, we recommend increasing the allocation to U.S. Treasury securities up to 10% of assets through the purchase of securities maturing in the 12 – 18 month range

- **Maintain allocation to the State LGIP.** Yields on money market funds, such as the State LGIP, tend to lag declines in market rates. We would recommend evaluating alternative investment sectors against the Washington State Local Government Investment Pool. If the LGIP offers a higher yield, which it currently does, we would suggest maintaining the allocation to the LGIP to enhance returns.

- **Shorten the portfolio's average maturity slightly to 8-9 months.** The average portfolio maturity modestly decreased to 9.0 months during the quarter. This was within PFM's recommended maturity range of 9-10 months. With yields expected to rise over the next 6 to 9 months, we suggest that the County shorten the portfolio slightly to protect against market risk. With $75 million in securities expected to mature in the first quarter with an additional $30 million expected to be called, it will be relatively easy to shorten the portfolio. In anticipation of a modest economic recovery and an upward bias in market yields during 2002, PFM recommends keeping the average maturity and effective duration near the low end of the target range.

- **Maintain allocation to callables.** As of December 31, 2001, 12% of the County's portfolio remained invested in callable Federal Agency securities. This is well within PFM's recommended maximum of 20-25% allocation in callable securities. $30 million of the current holdings are subject to call during the first quarter. Given the potential for higher rates and the proclivity for callable securities to extend as yields rise, we recommend that the County continue to limit its use of callable securities in this environment.

The sector and maturity composition recommendations below are based on our current market assessment, the County's investment objectives and limitations imposed by the County's investment policy.

Investment Sector	Recommended Average Maturity	Current Average Maturity	Recommended % of Portfolio	Current % of Portfolio
U.S. Treasury Obligations	9 months - 1.5 years	16.1 Months	5% - 15%	7%
Federal Agency Notes/Discount Notes	6 months - 2.0 years	1.05 Years	50% - 75%	61%
Municipal Obligations	6 months - 2.0 years	0.50 Years	0% - 5%	1%
Commerical Paper, Certificates of Deposit, Domestic Banker's Acceptances, State Pool	1 - 60 days	3 Days	20% - 40%	31%
Aggregate Average Maturity	**8 - 9 months**	**9.0 Months**		